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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 14, 1930

CERTIORARI GRANTED OCTOBER 20, 1930

(35,273)

(35,273)

SUPREME COURT OF THE UNITED STATES

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A. JAMES ECKERT, PETITIONER,

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 22, 1930

[fol. a-1]

BEFORE U. S. BOARD OF TAX APPEALS

Docket No. 29656

A. JAMES ECKERT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

For Taxpayer: Henry T. Dorrance, Esq.
For Commissioner: Hartford Allen, Esq., and Hugh Brewster, Esq.

DOCKET ENTRIES

1927.
July 14. Petition received and filed. Taxpayer notified.
" 15. Copy of Petition served on General Counsel. (Fee Paid.)
Aug. 18. Answer filed by General Counsel.
" 20. Copy of answer served on taxpayer. General Calendar.
1929.
Feb. 12. Hearing set March 28, 1929.
Mar. 20. Notice substituting Henry T. Dorrance for C. R. Dewey, attorney for taxpayer filed.
" 28. Hearing had before Mr. Arundell on merits. Submitted. Briefs due 4-30-29. No exchange.
Apr. 10. Transcript of hearing 3-28-29 filed.
" 26. Brief filed by taxpayer.
" 29. Brief filed by General Counsel.
[fol. 2]
Sept. 17. Findings of fact and opinion rendered. C. Rogers Arundell, Div. 7. Judgment will be entered for respondent.
" 20. Decision entered. C. Rogers Arundell, Div. 7.
Oct. 9. Supersedeas bond for $6,757.78 approved and filed.
1930.
Jan. 13. Petition for review to U. S. Circuit Court of Appeals, 2nd Circuit with assignments of error, filed by taxpayer (1).

Jan. 21. Proof of service filed.
" 16. Præcipe filed by taxpayer.
" 24. Proof of service filed.

Now, February 13, 1930, the foregoing Docket Entries certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed July 14, 1927

The petition of A. James Eckert respectfully shows:

I. The petitioner is an individual with residence on Paris Road in the Village of New Hartford, County of Oneida and State of New York.

II. The Commissioner of Internal Revenue has determined that there is a deficiency in respect of income tax imposed against the petitioner by the Revenue Act of 1924, notice of such deficiency having been issued to petitioner by letter dated, registered and mailed to petitioner on June 4, 1927, a copy of which deficiency letter and notice bearing symbol number IT:PA:3:60D:RMH is hereto annexed and made a part hereof.

III. The amount of the deficiency, the nature of the tax, the year for which asserted and the amount thereof (as [fol. 4] nearly as may be determined) in controversy is as follows:

(a) The amount of the deficiency is $3,378.89.

(b) The tax is income tax.

(c) The year for which the tax is asserted is the year 1925.

(d) The amount of the deficiency in controversy is the entire amount of the deficiency assessed—$3,378.89.

IV. The following error is alleged to have been commited by the Commissioner:

The Commissioner erred in disallowing as a deduction from income for the taxable period, as a bad debt, the sum of $22,400.00, representing indebtedness of the Electric Refrigerator Co., Inc., to the petitioner in that amount.

V. The facts on which the petitioner relies as sustaining the aforesaid assignment of error are as follows:

Prior to 1922 the petitioner and one William A. Ainsworth had been engaged in a partnership under the name of the Electric Refrigerating Company.

In 1922 a corporation was organized under the name of The Electric Refrigeration Co., Inc., taking over the assets of the partnership and assuming all its liabilities among which were notes in the amount of $25,419.65. Thereafter and in the course of its business the corporation made and [fol. 5] issued additional notes payable in the amount of $19,375.25. All of these notes were either endorsed or guaranteed by the petitioner and the said William A. Ainsworth.

In 1925 the business of the corporation was discontinued, it being found on the dissolution that there were practically no assets and that the corporation was totally unable to pay off any of the aforesaid notes in the amount of $25,419.65 assumed by it, or the $19,375.25 made by it, all of which notes were either endorsed or guaranteed by the petitioner and William A. Ainsworth, personally.

The bank holding the notes called the same and the petitioner and William A. Ainsworth were obliged to pay the entire amount. This they did by borrowing from the bank the sum of $44,800.00, giving their personal notes therefor, whereupon the old notes were marked paid and surrendered. No payments have been or will be received by the petitioner or by Mr. Ainsworth from the corporation by way of reimbursement.

The petitioner claimed his one-half of the total amount paid by him and Mr. Ainsworth as a proper deduction for the year 1925, writing the same off as a bad debt in the amount of $22,400.00.

Wherefore petitioner respectfully prays for the redetermination by this Board of the deficiency in respect of the

[fol. 6] tax assessed by the Commissioner as aforesaid, and for such other and further relief as may be just and proper.

Dated Utica, N. Y., July 12th, 1927.

C. R. Dewey, Counsel for Petitioner. Office & P. O. Address: First National Bank Bldg., Utica, New York.

Duly sworn to by A. James Eckert. Jurat omitted in printing.

[fol. 7] Treasury Department, Washington

Office of Commissioner of Internal Revenue

IT:PA:3:60D. RMH.

June 4, 1927.

Mr. A. James Eckert, Paris Road, New Hartford, New York.

SIR: The determination of your income tax liability for the years 1924 and 1925, as set forth in office letter dated April 13, 1927, disclosed a deficiency in tax amounting to $3,378.89, for the year 1925. The adjustments made are shown in the attached statement.

In accordance with the provision of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals [fol. 8] and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Ap-

peals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA:3:60:RMH. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully, D. H. Blair, Commissioner, by C. R. Nash, Assistant to the Commissioner.

Inclosures: Statement, Form A, Form 882.

[fol. 9] Statement

IT:PA:3:60D. RMH.

June 4, 1927.

In re Mr. A. James Eckert, Paris Road, New Hartford, New York.

Year	Deficiency in tax
1924	None
1925	$3,378.89
Total	$3,378.89

The report of the Internal Revenue Agent in Charge at Buffalo, New York, transmitted to this office under date of March 30, 1927, has been reviewed and approved.

The information submitted at the conference in this office on May 6, 1927, relative to the disallowance of the deduction of $22,800.00 for bad debts has been carefully considered. The letter dated May 20, 1927, from the Citizens Trust Company of Utica, New York, has also been considered. The agent disallowed the deduction on the grounds that no cash was paid by you and that your individual notes were given to replace the old notes of the partnership and the corporation on which you were an endorser. Inasmuch as you reported income on the cash receipts and disbursements basis the revenue agent is correct. Your protest is accordingly denied. This procedure is in accordance with A. R. M. 201, Cumulative Bulletin II-1, Page 86.

[fol. 10] Payment of the tax in question should not be made until a bill is received from the Collector of Internal

Revenue for your district, and remittance should then be made to him.

Now, February 13, 1930, the foregoing Petition certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed Aug. 18, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

[fol. 11] 1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3.

4. Denies that any error has been committed in the determination of the deficiency.

5. The allegations contained in paragraph 5 on page 2 of the petition are admitted.

The allegations contained in the first paragraph on page 3 of the petition are denied for lack of sufficient information to form a belief.

Denies generally and specifically each and every allegation in taxpayer's petition contained not hereinbefore admitted, qualified or denied.

Wherefore, having fully answered the petition of the above-named taxpayer, the respondent prays that his appeal be denied.

A. W. Gregg, General Counsel, Bureau of Internal Revenue. Of Counsel: Henry Ravenel, Hugh Brewster, Special Attorneys, Bureau of Internal Revenue.

Now, February 13, 1930, the foregoing Answer certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 12] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 29656

A. JAMES ECKERT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Promulgated September 17, 1929

FINDINGS OF FACT AND OPINION

The amount of a note given by the petitioner in settlement of his liability as an indorser of a note is not deductible from gross income, he being on the cash receipts and disbursements basis and no cash having been paid on the note during the taxable year.

Henry T. Dorrance, Esq., for the Petitioner.
Hartford Allen, Esq., and Hugh Brewster, Esq., for the Respondent.

This proceeding was instituted to redetermine a deficiency of $3,378.89 in income tax for the year 1925. The question in controversy is whether the sum of $22,400, representing one-half of the amount of a note given by the petitioner and another individual in payment of their liability as indorsers of a note, is deductible from gross income as a loss or a bad debt.

[fol. 13] Findings of Fact

Prior to 1922 the petitioner and William A. Ainsworth were engaged in business as partners under the firm name of Electric Refrigeration Company. In 1922 they organized a corporation under the name of Electric Refrigeration Co., Inc., which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, N. Y., for money loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several addi-

tional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid balance of $44,800, after charging about $5 to the personal account of the petitioner. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank, their joint note for $44,800 in settlement of their liability as indorsers of the corporation's [fol. 14] notes and in return received the corporation's notes stamped "paid." The notes were subsequently destroyed by the petitioner.

The liquidation of his liability as an indorser of the corporation's note did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of account. His return for the taxable year was filed on the basis of cash received and disbursed.

In his determination of the deficiency in controversy, the respondent declined to allow any amount of the note as a deduction from gross income on the ground that no cash payments were made on the notes during the taxable year.

Opinion

ARUNDELL: The position of the petitioner is that by reason of the fact that he was compelled to make good his liability as an indorser of the corporation's notes, he is entited to a deduction of $22,400 (one-half of the amount of the note given by the petitioner and Ainsworth), even though the note was not paid by cash. The respondent contends on the other hand that the amount is not deductible either as a loss sustained or a bad debt since the petitioner did not during the taxable year disburse any cash or its equivalent in property. The facts are not in dispute.

Section 212 of the Revenue Act of 1924 provides:

[fol. 15] (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of thetaxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer * * *.

Section 214 (a) of the same Act provides that in computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(7) Debts ascertained to be worthless and charged off within the taxable year * * *.

In Jackson County State Bank, 2 B. T. A. 1100, we said: "The expression 'losses sustained' means actual losses and not paper losses." To be entitled to a deduction for a loss, a taxpayer "must prove as a fact that it was actually sustained within the year". Carl Muller, 4 B. T. A. 169. In E-ectric Reduction Co. v. Lewellyn, 11 Fed. (2d) 493 (Reversed 275 U. S. 243 on other grounds) the following appears:

"Failure to keep that which one has is a loss. Foehren-[fol. 16] bach v. German-American Title & Trust Co., 66 A. 561, 217 Pa. 332, 12 L. R. A. (N. S.) 465, 118 Am. St. Rep. 916. There are many kinds of loss: Money out of pocket; a judgment, changing the status from solvency to insolvency. Schambs v. Fidelity & Casualty Co., 259 F. 55, 58, 170 C. C. A. 55, 6 A. L. R. 1231."

The petitioner in the case of Morris Sass, 12 B. T. A. 156, claimed the right to deduct as a loss the amount of a note he gave a bank in satisfaction of his contract of guaranty on a number of loans, he being on the cash basis in the year in which the instrument was executed. In sus-

taining the Commissioner's action disallowing the sum of the note as a deduction, we said:

"The giving of a note does not constitute a disbursement or deprivation of cash, nor does it necessarily constitute a disbursement of the equivalent thereof. In giving his note to the bank, petitioner gave evidence of his indebtedness in the amount of $19,253.54 incurred as a guarantor, but being on the cash receipts and disbursements basis he did not sustain an actual and deductible loss, i. e., a deprivation of his property, until he paid the note subsequent to 1919."

An identical situation exists here. The petitioner did not at any time during the taxable year pay out any cash or its equivalent in property in satisfaction of his liability to the holder of the corporation's notes. He merely exchanged his note under which he was primarily liable for [fol. 17] the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value. Not having paid out anything either prior to or during the taxable year, the petitioner had no investment to lose or to charge off as valueless. His cash assets were not diminished in any amount by the giving of the note. In our opinion the petitioner is not entitled to a deduction of the amount claimed either as a loss or as a worthless debt of the corporation. See Morris Sass, supra, and Morris Sass, 17 B. T. A. —, Promulgated September 17, 1929.

Reviewed by the Board.

Judgment will be entered for the respondent.

Smith dissents.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

Now, February 13, 1930, the foregoing Findings of Fact and Opinion certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

(Seal.)

[fol. 18] BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 29656

A. JAMES ECKERT, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Board's findings of fact and opinion, promulgated September 17, 1929, it is

Ordered and Decided: That there is a deficiency of $3,378.89 for the year 1925.

Enter.

(Signed) C. Rogers Arundell, Member United States Board of Tax Appeals.

Entered Sept. 20, 1929.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

[fol. 19] Now, February 13, 1930, the foregoing Decision certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

A. JAMES ECKERT, Petitioner-Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW—Filed Jan. 13, 1930

To the Circuit Court of Appeals for the Second Circuit:

The petition of A. James Eckert respectfully shows:

[fol. 20] 1. This is a proceeding for the review by the U. S. Circuit Court of Appeals for the Second Circuit of a

decision of the U. S. Board of Tax Appeals entered on September 20th, 1929, ordering and deciding that there is a deficiency in income tax for the year 1925 against the petitioner in the amount of $3,378.89.

2. Your petitioner is a resident of the Village of New Hartford, County of Oneida and State of New York.

3. The nature of the controversy before the Board of Tax Appeals was the determination of income taxes for the year 1925 involving the disallowance by the Commissioner of the sum of $22,400.00 claimed by the taxpayer as a deduction from income as a bad debt or business loss for the year 1925.

The claim of the taxpayer arises from undisputed facts that are summarized in the Findings of the Board as follows:

"Prior to 1922 the petitioner and William A. Ainsworth were engaged in a business as partners under the firm name of Electric Refrigeration Company. In 1922 they organized a corporation under the name of Electric Refrigeration Co., Inc., which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, N. Y., for money [fol. 21] loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several additional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently, in 1925, the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid balance of $44,800., after charging about $5 to the personal account of the petitioner. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank, their joint note for $44,800 in settle-

ment of their liability as indorsers of the corporation's notes and in return received the corporation's notes stamped "paid". The notes were subsequently destroyed by the petitioner.

The liquidiation of his liability as an indorser of the corporation's note did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of [fol. 22] account. His return for the taxable year was filed on the basis of cash received and disbursed."

4. The error committed by the Board of Tax Appeals upon which the petitioner relies upon as the basis of the proceeding is as follows:

(a) The Board erred in disallowing as a deduction from income for the taxable period as a bad debt or business loss, the sum of $22,400.00 representing notes and indebtedness of the Electric Refrigeration Co., Inc., to the petitioner in that amount which were acquired by the petitioner and were ascertained to be worthless in 1925 and deducted for that year.

(b) The Board erred in basing its decision on the ground that notes and not cash were paid in 1925 by the petitioner, disregarding the fact that the petitioner is here claiming a bad debt deduction on the notes of the Electric Refrigeration Co., Inc., acquired as aforesaid, and not a business loss represented by the new personal notes which were given.

Wherefore your petitioner prays that this court may review the action of the Board of Tax Appeals in this cause, reverse the decision of the Board, and direct the entry of a decision by said Board in favor of the petitioner, determining that there is no deficiency in income tax for the year 1925 due from the petitioner and for such other [fol. 23] and further relief as to this court may appear proper in the premises.

(Sgd.) Henry T. Dorrance, Attorney for Petitioner-Appellant. Office and Post Office address: 1015-1025 First National Bank Bldg., Utica, N. Y.

Duly sworn to by A. James Eckert. Jurat omitted in printing.

Now, February 13, 1930, the foregoing Petition for Review certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 24] In United States Circuit Court of Appeals

[Title omitted]

Præcipe for Transcript of Record—Filed Jan. 16, 1930

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of the record in this cause and on or before March 13th, 1930, transmit the same to the Clerk of the U. S. Circuit Court of Appeals for the Second Circuit and include in said transcript copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the Board in the above entitled cause.
2. Petition for Redetermination filed July 14th, 1927.
3. Answer to Petition filed August 18th, 1927.

[fol. 25] 4. Findings of Fact and Opinion of the Board promulgated September 17th, 1929.

5. Order and Decision entered September 20th, 1929.
6. Petition for Review filed January 13th, 1930.

Said transcript to be prepared as required by law and the rules of the U. S. Circuit Court of Appeals for the Second Circuit.

Henry T. Dorrance, Attorney for Petitioner-Appellant. Office and Post Office address: 1015-1025 First National Bank Bldg., Utica, N. Y.

Now, February 13, 1930 the foregoing Præcipe for Transcript certified from the record as a true copy.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal.)

[fol. 26] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1929

No. 333

Argued May 6, 1930. Decided June 2, 1930

A. JAMES ECKERT, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

Before Manton, Swan, and Augustus N. Hand, Circuit Judges

Petition to review an order of the Board of Tax Appeals which determined a deficiency in the taxpayer's return for the year 1925. The taxpayer appeals. Order affirmed.

Dunmore, Ferris & Dewey, of Utica, N. Y. (Henry T. Dorrance, of Utica, N. Y., of counsel), for petitioner.

G. A. Youngquist, Asst. Atty. Gen., J. Louis Monarch and Helen R. Carloss, Sp. Assts. to Atty. Gen. (C. M. Charest, Gen. Counsel, Bureau of Internal Revenue, of Washington, D. C., and Dewitt M. Evans, Sp. Atty., Bureau of Internal Revenue, of Washington, D. C., of counsel), for respondent.

OPINION

MANTON, Circuit Judge:

The petitioner was engaged in business, prior to 1922, with a partner, under the firm name of Electric Refrigerator Company. In 1922 they incorporated the business under the name of Electric Refrigerator Company, Inc., which acquired the assets and assumed the liabilities of the partnership, including promissory notes of $25,419.65 payable to a bank for money loaned to the partnership. The bank accepted notes executed by the corporation for the partnership notes and later several additional notes for money loaned, amounting to $19,375.25, were given to the bank. All the notes issued by the corporation in favor of

the bank were indorsed by the petitioner and his former partner.

In September, 1925, the bank demanded payment, and subsequently the corporation discontinued business and was dissolved; its assets being insufficient to pay the amount due on the notes in excess of $600. This left a balance of $44,800, for which the petitioner and his partner delivered to the bank a joint note of $44,800 in settlement of this liability as indorsers of the corporation's notes and in return received the corporation notes marked "Paid." The notes thus given were not paid in 1925, and there was no cash transaction in connection with the making and delivery of the notes.

The petitioner filed his return for the year in question on the basis of cash received and disbursed. The respondent declined to allow any amount of the note as a deduction from gross income, for the reason that no cash payments had been made on the notes during the taxable year. The Board of Tax Appeals affirmed this ruling.

A taxpayer keeping his books or doing business on a cash received and disbursed basis can only deduct items actually paid in cash during the year. The Revenue Act of 1924, § 212 (43 Stat. 267, 26 USCA § 953) provides: "(a) In the case of an individual the term 'net income' means the gross income as defined in section 954 of this title, less the deductions allowed by sections 937 and 955. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of [fol. 27] such taxpayer." Section 214(a) of the same act (26 USCA § 955) provides that in computing net income there shall be allowed as deductions: "(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business; * * * (7) Debts ascertained to be worthless and charged off within the taxable year. * * *"

It is essential that the taxpayer make his return on a basis that clearly reflects the true net income, and to that end the Commissioner has properly recognized two systems of accounting—(a) accrual system and cash accrual; and (b) cash receipts and disbursements. Under the accrual method, the taxpayer returns as income all items of income

receivable, whether actually received or not, and deducts items of expense for which liability is incurred whether he has actually paid them or not. But, when his method is on a cash receipt and disbursement basis, he need only report income received in cash, and is allowed to deduct items of expense actually paid or losses actually sustained. The taxpayer may not employ one method in accounting for income derived and the other in making the authorized deductions for the purpose of ascertaining his net income which is subject to taxation. American Nat. Co. v. United States (1927) 274 U. S. 99, 47 S. Ct. 520, 71 L. Ed. 946; United States v. Mitchell (1926) 271 U. S. 9, 46 S. Ct. 418, 70 L. Ed. 799; United States v. Anderson (1926) 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347. While here the petitioner says he kept no books. Still, in filing his return, he indicated a cash receipt and disbursement basis, and the Commissioner was authorized to require him to account for the loss of the transaction here involved in a manner consistent with the cash receipt and disbursement method of accounting.

On this basis, petitioner did not lose by reason of his indorsement or assumption of a corporation's obligation to the bank by issuing his own note. His liability on the corporation's note arose by reason of the indorsement, and, when he sustains a loss, it must be attributable to that alone. That loss will be realized and may be recognized when payment of the note or part thereof is made in cash. Osterloh v. Lucas (1930) 37 F. (2d) 277 (C. C. A. 9). The giving of a note does not constitute a cash payment. The obligation to pay the amount of the note may be as binding, for instance, as payment of taxes, but it has been determined that a taxpayer on a cash received and disbursed basis cannot deduct taxes before they are actually paid. United States v. Mitchell, supra. Nor can a taxpayer who subscribes to a charitable fund, deduct the subscription until he has paid it. Mann v. Commissioner (App. D. C. 1929) 35 F. (2d) 873. The taxpayer not having sustained a loss because he did not pay the note or any part thereof in the year 1925, the Commissioner properly held that he was not entitled to this deduction. Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it.

Order affirmed.

[fol. 28] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

A. JAMES ECKERT, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

JUDGMENT—Filed June 9, 1930

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fols. 29 & 29½] [File endorsement omitted.]

[fols. 30-35] Petition for rehearing, covering six pages, omitted from this print. It was denied and nothing more by order July 3, 1930.

[fol. 36] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals in and for the Second Circuit, held at the courtrooms, in the Post Office building, in the city of New York, on the 3rd day of July, one thousand nine hundred and thirty.

[Title omitted]

ORDER DENYING REHEARING—Filed July 7, 1930

A petition for a rehearing having been filed herein by counsel for the petitioner;

Upon consideration thereof it is
Ordered that said petition be and hereby is denied.
Wm. Parkin, Clerk.

[fol. 37] [File endorsement omitted.]

[fol. 38] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 39] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 20, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 35,273. U. S. Circuit Court of Appeals, Second Circuit. Term No. 351. A. James Eckert, petitioner, vs. Commissioner of Internal Revenue. Petition for writ of certiorari and exhibit thereto. Filed August 14, 1930. File No. 35,273.

FILE COPY

AUG 14 1
CHARLES ELMORE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

C. R. DEWEY,
Counsel for Petitioner.

(35,273)

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Supreme Court of the United States:

The petition of A. James Eckert respectfully shows:

1. On or about September 20th, 1929, the United States Board of Tax Appeals made and entered its decision and order determining a deficiency in the petitioner's income tax for the year 1925 in the amount of $3,378.89; appeal was duly taken by the United States Circuit Court of Appeals for the Second Circuit; on June 2nd, 1930, the Circuit Court of Appeals

affirmed the order of the United States Board of Tax Appeals; and a petition for rehearing was denied on June 26th, 1930.

2. The matters involved are as follows:

(*a*) The only issue in the case is whether the petitioner in computing his net income for income tax purposes is entitled to deduct from income as a bad debt, the sum of $22,400.00 representing indebtedness of the Electric Refrigeration Co., Inc., to the petitioner.

(*b*) The facts are undisputed. They may be summarized as follows:

Prior to 1922.—Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922.—A corporation was organized under the name "Electric Refrigeration Co., Inc.," which took over all the assets and assumed all of the liabilities of the partnership among which were notes of $25,419.65.

1922-1925.—The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y., for around $45,000.00. These notes were made by the corporation, but all of them were endorsed or guaranteed by the petitioner and Ainsworth.

1925.—The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount of the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a loss or bad debt for the year 1925.

(*c*) The petitioner claims a bad debt deduction based on his one-half of the notes of the corporation which he was obliged to take up as aforesaid—and not a business loss represented by the new personal notes given.

This is the vital distinction to be kept in mind, but a distinction both the Board and the Circuit Court of Appeals ignored.

The petitioner does not claim a business loss represented by the new personal notes—the petitioner claims a bad debt deduction for the corporation's notes which he acquired, ascertained to be worthless and charged off in 1925: a deduction authorized under Section 214

(*a*) of the Revenue Act of 1924 which provides that in computing net income there shall be allowed as deductions:

> "7. Debts ascertained to be worthless and charged off within the taxable year."

3. The reasons relied on for the allowance of the writ of certiorari hereinafter prayed for are as follows:

(*a*) While the amount involved in the case at bar is small, the principle and rule of law in question are of great importance both to the taxpayers generally and to the Government.

(*b*) There is a conflict between the decisions of the Circuit Courts of Appeals for the several Circuits. The holding in the case at bar is contrary to the decision of the Circuit Court of Appeals for the Seventh Circuit in the case of

> *S. R. Davis v. Commissioner*, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H. Tax Service, Par. 195.411).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidat-

ing dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

Therefore it will be seen from the above that the decisions of the several Circuits are not in harmony, since the holding by the Circuit Court of Appeals in the case at bar is the same as the holding of the Board in the S. R. Davis case—which holding was reversed by the Circuit Court of Appeals for the Seventh Circuit.

(*c*) The petitioner's position is a sound one.

While no extended discussion is proper here we believe that the position of the petitioner is a proper one for reasons which may be summarized as follows:

1. On payment to the Bank, the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation.

2. The notes thus acquired were ascertained to be worthless in 1925, being charged off in that year.

3. The petitioner's share of the corporation's notes was therefore properly deductible as a bad debt for the year 1925, the absence of cash appearing in the transaction being immaterial.

WHEREFORE your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding said Court to certify and transmit to this Court, on a day to be therein designated, a full and complete transcript of the record and all proceedings of the said Court in this case, to the end that this case may be reviewed and determined by this Court as provided by law, and that the said judgment of the said Court in this case may be reversed by this Honorable Court and that your petitioner may have such other and further relief as to this Court may seem appropriate and in conformity with law.

C. R. DEWEY,
Counsel for Petitioner.

Office and P. O. Address: First National Bank Bldg., Utica, New York.

(5382)

FILE COPY

FILED
AUG 14 1930
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

C. R. DEWEY,
Counsel for Petitioner.

(35,273)

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Statement of Grounds on Which Jurisdiction of Court is Based.

This is an application for writ of certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit made and entered June 2nd, 1930, affirming the order of the United States Board of Tax Appeals entered September 20th, 1929.

The decision of the United States Board of Tax Appeals is reported in Eckert *v.* Commissioner, 17 B. T.

A., 263; that of the Circuit Court of Appeals has not as yet been officially reported.

This application is made under Section 240 of the Judicial Code and accompanying and pertinent provisions.

Statement of Case.

The matters involved may be summarized as follows:

(*a*) The alleged deficiency in tax is income tax for the year 1925 in the amount of $3,378.89.

(*b*) The only issue in the case is whether the petitioner in computing his net income for income-tax purposes is entitled to deduct from income as a bad debt the sum of $22,400.00, representing indebtedness of the Electric Refrigeration Co., Inc., to the petitioner.

(*c*) The facts are undisputed. They may be summarized as follows:

Prior to 1922.—Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922.—A corporation was organized under the name "Electric Refrigeration Co., Inc.," which took over all the assets and assumed all the liabilities of the partnership among which were notes of $25,419.65.

1922-1925.—The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y.,

for around $45,000.00. These notes were made by the corporation, but all of them were endorsed or guaranteed by the petitioner and Ainsworth.

1925.—The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount on the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a loss or bad debt for the year 1925.

(*d*) The petitioner claims a bad-debt deduction based on his one-half of the notes of the corporation which he was obliged to take up as aforesaid and not a business loss represented by the new personal notes given.

This is the vital distinction to be kept in mind, but a distinction that both the Board and the Circuit Court of Appeals ignored. Both the Board and the Circuit Court of Appeals directed practically their entire consideration and discussion to the question whether the petitioner could deduct a loss represented by the per-

sonal notes which he gave—and as already stated, this is not the contention of the petitioner.

The petitioner does not claim a business loss represented by these new personal notes—the petitioner claims a bad-debt deduction for the corporation's notes which he acquired, ascertained to be worthless, and charged off in 1925.

The deduction is claimed under Section 214 (*a*) of the Revenue Act of 1924, which provided that in computing net income there shall be allowed as a deduction:

> "7. Debts ascertained to be worthless and charged off within the taxable year."

Outline of Argument.

In support of petitioner's application for a writ of certiorari, the petitioner respectfully advances the following points:

1. *While the amount involved in the case at bar is small, the principle and the rule of law in question are of great importance, both to the taxpayers generally and to the Government.*

2. *There is a conflict between the decisions of the Circuit Courts of Appeals for the several Circuits, which conflict should be settled by an adjudication of this court.*

3. *The position of the taxpayer is a sound one.*

ARGUMENT.

Point I.

While the amount involved in the case at bar is small, the principle and the rule of law in question are of great importance, both to the taxpayers generally and to the Government.

The situation involved in the case at bar is one which is constantly presenting itself.

Its importance to taxpayers generally and to the Government cannot therefore be over estimated.

Point II.

There is a conflict between the decisions of the Circuit Courts of Appeals for the Several Circuits, which conflict should be settled by an adjudication of this Court.

The Circuit Court of Appeals in the case at bar has by its decision refused to allow the petitioner to deduct as a bad debt his share of the notes of the corporation which he acquired in 1925 and ascertained to be worthless and charged off in that year, basing the decision largely on the ground that no cash passed at the time of the transaction.

This holding is directly contrary to the holding of the Circuit Court of Appeals for the Seventh Circuit in the case of

S. R. Davis v. Commissioner, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H. Tax Service, Par. 194.411).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidating dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income-tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

Therefore it will be seen from the above that the decisions of the several Circuits are not in harmony, since the holding by the Circuit Court of Appeals in the case at bar is the same as the holding of the Board in the S. R. Davis case—which holding was reversed by the Circuit Court of Appeals for the Seventh Circuit.

Point III.

The position of the taxpayer is a sound one.

The petitioner realizes that the primary purpose of this brief, accompanying the petition for a writ of certiorari, is to satisfy this Court that there

is an issue involved in this case which should be passed on by this Court to settle the conflict in authorities that now exists in the lower courts.

Therefore your petitioner realizes that any detailed argument substantiating the correctness of the petitioner's position would be out of place.

It may not, however, be amiss to outline the following reasons on which is based the petitioner's position.

1. *On payment to the bank the petitioner and Ainsworth became the owners of the notes of the corporation which they had a right to enforce against the corporation.*

This point needs no citation of authority, for automatically one who takes up notes on which he is an endorser becomes the owner of the notes and has a right to enforce them against the corporation.

Knowing these notes to be worthless in 1925, each naturally wrote off his one-half as a bad debt—a thing which he would naturally assume he had a perfect right to do.

2. *The notes thus acquired were ascertained to be worthless in 1925 being charged off in that year.*

This point has not been disputed.

3. *The petitioner's share of the corporation's notes was therefore properly deductible as a bad debt for the year 1925, the absence of cash appearing in the transaction being immaterial.*

Section 214 (*a*) of the Revenue Act of 1924 provides that in computing net income there shall be allowed as deductions:

> (4) Loss sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (7) Debts ascertained to be worthless and charged off within the taxable year * * *

We believe that the deductibility of the amount in dispute would be conceded if cash had actually passed when the corporation's notes were taken up.

We think that this objection rests upon a misapprehension of the petitioner's position, and that in the present case the absence of cash does not prevent deductibility for the following reasons:

(*a*) *We are here claiming a bad debt deduction on the notes of the corporation acquired as aforesaid—not a business loss represented by the new personal notes given.*

This is the vital distinction to be kept in mind.

We do not claim a business loss represented by the new personal notes; we claim a deduction for the corporation's notes, ascertained to be worthless in 1925.

(*b*) *In such a case, the presence of cash is not required by the authorities.*

The Board and the Circuit Court of Appeals have, we believe, confused this case with the ordinary case

where a taxpayer on a cash basis attempts to claim a loss for notes given by him but not yet paid.

These cases are numerous and sound, but have no application here, where the deduction is based on the notes acquired.

Under the authorities, the taxpayer is entitled to deduct his share of the worthless notes in 1925.

To the best of our knowledge there are only three cases in which this question is considered, and all of them are decisive of the question in our favor.

S. R. Davis v. Commissioner, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H., Tax Service, Par. 195.411).

The case cited has already been discussed under Point II. Its holding is directly contrary to that of the Court in the case at bar, and directly in accord with the petitioner's position.

The second case in which the point here involved is considered is

A. W. D. Weis v. Commissioner, 13 B. T. A., 1284.

In the case cited, the petitioner and one Morgan conducted a lumber company which gave to the bank its notes. In 1919 the bank called the notes and the petitioner gave his personal note for the amount of the principal and interest due on the company's note which he took up. The business was wound up in 1919 and it was then ascertained that the company would have little or no assets to apply on its note. The personal note given by the petitioner was not

paid until 1923. Nevertheless the petitioner was allowed to deduct in the year 1919 the amount of the principal and interest due on the corporate notes which he had taken up.

The third case in which the point here at issue has been considered is that of

Maurice Sass v. Commissioner, 7 B. T. A., 557; modified in 12 B. T. A., 156; affd. in 17 B. T. A., 261.

Here the petitioner claimed as a deduction the amount due on notes guaranteed by the petitioner which he had been obliged to take up and for which he had substituted his own notes not paid in the taxable year. The final holding of the Board was that the deduction could not be taken because it was not shown that the notes taken up were worthless in the year in which taken up. The Board said in part, in 17 B. T. A., at 263:

> "* * * petitioner has not shown that he is entitled to a deduction of $19,253.54 by reason of the fact that he gave his note in that amount to the bank in the year 1919. Even under the petitioner's claim, in order to become entitled to a deduction of this amount, it is incumbent upon him to show by a preponderance of the evidence that the obligations of the borrowers, whose notes he had guaranteed, were worthless in the year 1919 and this he has failed to do. The mere fact that the bank called upon petitioner to take care of the unpaid notes of others, the payment of which he had guaranteed, and that he gave to the bank his promissory note, does not of itself prove that he has sustained a

deductible loss in the year in which he gave his note. When petitioner gave his note to the bank he was subrogated to all rights of the bank against the makers of the notes remaining unpaid at that time and there is not sufficient evidence in this record to convince the Board that the notes given to the bank and taken over by petitioner were worthless and uncollectible in the taxable year. This fact distinguishes this case from the proceeding of S. R. Davis, 9 B. T. A., 755, and A. W. D. Weis, 13 B. T. A., 1284."

But in the case at bar there is proof—and in fact no contention to the contrary—that the notes of the corporation which the petitioner took up were worthless and were ascertained to be worthless in the year 1925; the Board finding that "subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600.00;" and the petitioner and Ainsworth being obliged to take care of the rest by giving their notes for the deficiency of $44,800.00.

We shall not, however, pursue this angle further, since if the Commissioner's sole requirement is the presence of tangible consideration passing from the taxpayer, this requirement can readily be met.

(c) *As to $25,000.00 of the notes, the petitioner has actually paid out tangible consideration.*

The petitioner and Ainsworth in 1922 had partnership property and partnership liabilities, among them notes in the amount of $25,000.00.

They parted with the property in 1922 in return for the assumption of the liabilities.

In other words, the partners conveyed their property in return for the corporation's promise to pay the liabilities and hold the partners indemnified.

This obligation of the corporation was represented, at least up to $25,000.00, by the notes on which the corporation was primarily liable as maker and the individuals secondarily liable as indorsers; and with respect to which the corporation was bound to hold the indorsers harmless, not merely by the express agreement of 1922, but also by the implied obligation imposed by law.

This obligation, represented by these notes, became worthless in 1925.

The petitioner had transferred his property in 1922 for this obligation. He had paid for it in tangible consideration in 1922. If it becomes worthless in 1925, why cannot he deduct it?

The suggestion was made that when the individuals in 1925 gave their notes they were remitted to their 1922 position. That is not so—their liabilities have returned, but their properties have not.

(d) As to the remaining $19,000.00 of notes issued after 1922, to insist on the presence of cash in their payment in 1925 would be to insist on an idle form.

While we believe that the presence of tangible consideration in respect to $25,000.00 of the notes will meet the objection of the Board as to that portion of

the notes, we admit that as to the remaining $19,000.00 no cash or property passed.

For reasons already advanced, we do not believe that the presence of cash or tangible consideration is important.

If, however, it be insisted on as to the remaining $19,000.00 of notes, we have an insistence on an idle form.

The situation, effect and result of the transaction is exactly the same as if the petitioner and Ainsworth in 1925 had gone to the Bank, given their notes, deposited the proceeds in their accounts, checked it out to the Bank, and taken up the notes.

It would seem unnecessary to insist on a mere matter of useless form; the result would seem to be the proper test.

And, as already said, the result was exactly the same as if cash had passed.

4. *The fact that the notes were worthless when acquired is immaterial.*

The entire opinion of the Circuit Court, with the single exception of the last sentence, and the entire citation of authorities, was directed to the same question which occupied the Board's attention—whether petitioner could deduct a loss represented by the personal notes which he gave—and that proposition is not in issue.

The only reference to petitioner's real claim, that he is entitled to a deduction as a bad debt of his share

of the worthless notes of the corporation, is the last sentence in the opinion, stating:

> "Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it."

No authority is cited for this statement; and the authorities hereinabove referred to show that in such a case as this, where a taxpayer is compelled to take up paper, its worthlessness at the time does not prevent its charge-off and deductibility for income tax purposes.

Conclusion.

In view of the importance of the question involved and of the conflict now existing between the decisions in the Circuit Courts of Appeal, petitioner respectfully prays that a writ of certiorari may issue out of this Court as prayed for in the accompanying petition.

Respectfully submitted,

C. R. DEWEY,
Counsel for Petitioner.

Office and P. O. address: First National Bank Bldg., Utica, New York.

FILE COPY

FILED
MAR 18 1931
CHARLES ELMORE CRO
CLER

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

---

BRIEF FOR PETITIONER

C. R. DEWEY,
HENRY T. DORRANCE,
Counsel for Petitioner
UTICA, NEW YORK.

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Argued by
HENRY T. DORRANCE

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 8-10) is reported in 17 B.T.A., 263. The opinion of the Circuit Court of Appeals is reported in 42 Fed. (2d) 158.

JURISDICTION

The jurisdiction of the Court is invoked under Section 240(a) of the Judicial Code.

The judgment of the Circuit Court of Appeals was entered June 9, 1930 (R. 18). A petition for re-hearing was denied July 7, 1930 (R. 18). The petition for a writ of certiorari was filed August 14, 1930 (R. 19) and the order allowing certiorari on October 20, 1930 (R. 19).

STATEMENT OF CASE

(a) The case involves an alleged deficiency in income tax for the year 1925 in the amount of $3,378.89 (R. 2).

(b) The facts are undisputed (R. 7-8). They may be summarized as follows:

Prior to 1922 — Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922 — A corporation was organized under the name "Electric Refrigeration Co. Inc." which took over all the assets and assumed all the liabilities of the partnership among which were notes of $25,419.65.

1922-1925 — The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y., for around $45,000.00. These notes were made by the corporation, but all of them were endorsed by the petitioner and Ainsworth.

1925 — The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount on the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a bad debt or loss for the year 1925.

The petitioner is on a cash basis and not on an accrual basis.

(c) From an income tax standpoint there are two possibilities as to the treatment of the transaction above outlined:

1st — The first alternative is to allow as a bad debt deduction the petitioner's one-half of the notes of the corporation which he was obliged to take up as aforesaid and which were ascertained to be worthless and were charged off in 1925. This treatment of the transaction is the one primarily urged and relied on by the petitioner before the Board of Tax Appeals, the Circuit Court of Appeals and before this Honorable Court. This contention however was almost entirely ignored both by the Board of Tax Appeals and the Circuit Court of Appeals.

2nd — The second alternative is to treat the transaction as one giving rise to a business loss measured by the new personal notes given. This alternative occupied most of the attention of the lower courts despite petitioner's efforts to direct that attention to the first alternative. The petitioner will briefly call this second alternative to the attention of this Court, but as already pointed out, the first alternative is primarily relied upon, petitioner feeling that his right to the deduction is clearly justifiable under the provisions of law thereto applicable.

(d) The statutory provisions involved are:

Revenue Act of 1926, Section 214 (a)

"Sec. 214 (a)—In computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

(7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part."

The Act of 1926 is made applicable to the year 1925 by Section 286.

SPECIFICATION OF ERRORS

The petitioner asks for a reversal of the judgment of the Circuit Court of Appeals on the ground that it is contrary to law, being based on a failure and refusal to allow petitioner the hereinbefore mentioned deduction from income in determining his income tax, to which deduction petitioner is entitled under the Revenue Act of 1926.

OUTLINE OF ARGUMENT

In support of his prayer that the judgment of the lower Court be reversed petitioner will advance the following points:

Point I. *The petitioner is expressly entitled by the provisions of Section 214(a)(7) of the Revenue Act of 1926 to deduct from income as a bad debt his share of the notes of the Electric Refrigeration Co. Inc., which he acquired, ascertained to be worthless and charged off in 1925, for*

(a) On payment to the Bank the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation;

(b) The notes thus acquired were ascertained to be worthless in 1925 and were charged off in that year.

Point II. *The arguments of the learned Solicitor General, some of which were approved by the lower Courts, are unsound, for*

(a) The fact that the notes were worthless when acquired is immaterial;

(b) The fact that no cash was involved in the transaction is immaterial;

(c) The Commissioner under Section 212 of the Revenue Act of 1926 has no power to deprive the petitioner of his specific right to a deduction from income conferred by Section 214(a) of that Statute;

(d) The treatment of the transaction urged by the petitioner most accurately reflects his income.

Point III. *Were an additional ground necessary to permit deduction it might be found on the theory of a business loss sustained by petitioner and deductible under Section 214(a)(4)(5) of the Revenue Act of 1926.*

ARGUMENT

POINT I

The petitioner is expressly entitled by the provisions of Section 214(a)(7) of the Revenue Act of 1926 to deduct from income as a bad debt his share of the notes of the Electric Refrigeration Co. Inc., which he acquired, ascertained to be worthless and charged off in 1925, for

(a) On payment to the bank, the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation.

It is to be borne in mind that the old partnership notes were taken up and that in 1925 all of the notes were those made by the corporation on which Ainsworth and Eckert, who had endorsed for the accommodation of the corporation, were secondarily liable.

While the rule may not be the same in all states, in New York State, it has long been settled that where, in such a case, the endorsers pay such a note, the note is not discharged but the parties paying it become the owners of the note and may enforce it against the maker, being subrogated to all rights of the holders.

Negotiable Instruments Law of New York, Section 202.

"Right of party who discharges instrument. Where the instrument is paid by a party secondarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument * * *"

Negotiable Instruments Law of New York, Section 304.

"Effect on subsequent parties where bill is paid for honor. Where a bill has been paid for honor all parties subsequent to the party for whose honor it is paid are discharged, but the payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as regards the party for whose honor he pays and all parties liable to the latter."

Pittsburgh-Westmoreland Coal Co. v. Kerr, (1917) 220 N. Y., 137.

Gersetz Corporation v. Gramatan National Bank of Bronxville (1923) 205 A. D., 868.

Therefore, when the Bank marked the notes paid, and surrendered them to the taxpayer and Ainsworth, they became the sole and legal owners of the same and had the right to enforce them against the corporation.

Having secured the notes of the company by giving their joint personal notes, the ownership of the corporate notes was of course a tenancy in common under Section 66 of the Real Property Law of the State of New York which is held to apply to personal property as well as real property;

Matter of Kimberly, 150 N. Y., 90;

and each was the owner of an undivided one-half;

Jackson v. Moore (1904) 94 A. D., 504.

Matter of Klatzl (1915) 216 N. Y., 83 at 87 and 88.

McGreggor v. Walters (1928) 133 Misc., 24 at 25.

and each naturally wrote off his one-half as a bad debt—which he would naturally assume he had a perfect right to do.

(b) The notes thus acquired were ascertained to be worthless in 1925 and were charged off in that year.

It was of course definitely ascertained in 1925 that the notes were worthless, the corporation being liquidated in that year.

The taxpayer regarded and treated his share of the notes as a bad debt in 1925, destroying the notes as worthless in that year. It is true that there was no charging off on books of account, but this is not necessary where, as in the present case, no books of account are kept by the taxpayer.

Newton, et al., v. Commissioner of Internal Revenue, 7 B. T. A., 1153 at 1155:

"Since the petitioners kept no books of account the requirement that the bad debts be charged off before they can be claimed as a deduction does not apply to them."

Mitten v. Commissioner of Internal Revenue, 11 B. T. A., 731 at 733:

"As he kept no books of account no formal book entry or charge-off as mentioned in the statute was necessary in his case. See Huning Mercantile Co., 1 B. T. A., 130; Charles A. Collins, 1 B. T. A., 305; United States Tool Co., 3 B. T. A., 492."

POINT II

The arguments of the learned Solicitor General, some of which were approved by the lower Courts, are unsound, for

(a) The fact that the notes were worthless when acquired is immaterial.

The Circuit Court of Appeals dismissed the contention that the petitioner was entitled to a deduction for a bad debt in the following summary manner (R. 17):

> "Nor is the taxpayer entitled to a deduction under Clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it."

The Court cited no authorities for this statement and we believe that the statement is not supported by a reading of the Statute and a perusal of the decisions that have arisen thereunder.

It is true that the notes were worthless when acquired—but the Statute imposes no requirement that they be of value when acquired. Here again the Court is confusing a bad debt deduction with a loss deduction.

The petitioner was obliged to take up and did take up these notes. He acquired said notes at and for their face value; he ascertained said notes to be worthless; and he wrote them off in the year 1925. It is submitted that these facts are sufficient to warrant deduction under Section 214(a) of the Revenue Act of 1926 which provides that in computing net income there shall be allowed as deductions:

> "7. Debts ascertained to be worthless and charged off within the taxable year * * *"

A somewhat analogous situation was considered in:

E. B. Stephenson v. Commissioner of Internal Revenue, 43 Fed. (2d) 348,

where the taxpayer was allowed to take deduction with respect to advances to a pool to be used for taking up from the bank certain notes that were largely worthless at the time when acquired.

Likewise, deduction was allowed on account of stock worthless when purchased:

Worcester Bank & Trust Co., et al., v. Commissioner, 13 B. T. A., 630.

It has been held that a tax payer may write off as a bad debt for the year 1913 bonds that were worthless in that year, even though they may have become worthless prior to March 1st, 1913.

Plant v. Walsh, 280 Fed., 722 at 724.

"The defendant contends that the taxpayer is entitled to charge off only the amount of the actual value of the bonds on March 1, 1913; that the burden is on the taxpayer to establish this amount, and since there is no evidence to show what the bonds were actually worth on that date the entire deduction should be disallowed.

"The plaintiff contends that all the statute requires him to prove is that the debt was ascertained to be worthless and charged off within the year 1913. This he has done by the undisputed evidence. The effect of so construing the statute may be to permit the taxpayer to deduct five-sixths of a loss accruing prior to

the commencement of the taxable period, so that the return will not reflect his entire income for that period. But Congress has the right to do this, and has done it if the statute is to be literally construed. In case of doubt a tax law should be construed in favor of the taxpayer. *Gould v. Gould*, 245 U. S. 151, 38 Sup. Ct. 53, 62 L. Ed. 211. Therefore I conclude that the taxpayers contention should be sustained."

The respondent in the Circuit Court of Appeals, taking the position that no write-off can be had if the debt was worthless at the time of acquisition, attempts to justify this position by the argument that the words in the Statute "charged off" necessarily imply that the debt must first be "charged on" and cites in support of this contention the following cases:

Appeal of Charles A. Collin, 1 B. T. A., 305.

Henry V. Poor v. Commissioner, 11 B. T. A., 781; Affd. 30 Fed. (2d) 1019.

Charles K. Beekman v. Commissioner, 17 B. T. A., 643.

J. Noble Hayes v. Commissioner, 7 B. T. A., 936.

Appeal of Howard J. Simons, 1 B. T. A., 351.

None of these cases are here applicable, the cases cited merely holding that a taxpayer cannot charge off as a bad debt income which he expected to receive unless he had shown such income in prior returns—an obviously fair and logical ruling.

As already stated, there is nothing in the Statute that indicates that the debt must be of value at the time it is acquired in order to justify its being written off as a bad debt.

The Statute requires that the taxpayer shall be the owner of the debt; that it shall be ascertained to be worthless; that it shall be written off. All requirements are here present; and there is no justification for adding a further requirement, as the Commissioner seeks to do.

But were there ambiguity in the Statute, it should be resolved in favor of the taxpayer under the well settled doctrine of this Court.

Gould v. Gould (1917), 245 U. S., 151 at page 153.

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen. *United States v. Wigglesworth*, 2 Storey, 369; *American Net & Twine Co. v. Worthington*, 141 U. S., 468, 474; *Benzinger v. United States*, 192 U. S., 38, 55."

(b) The fact that no cash was involved in the transaction is immaterial.

We believe that the deductibility of the amount in dispute would be conceded by the Commissioner if cash had actually passed when the corporation's notes were taken up.

In other words, we understand that had the procedure been one whereby the taxpayer and Ainsworth first gave their notes to the Bank, deposited the proceeds in their checking account, and at once drawn checks to the Bank and taken up the notes in question, the Commissioner would concede the propriety of the deduction, the only objection being based on the absence of cash.

We think that this objection rests upon a mis-apprehension of the taxpayer's position, and that in the present case, the absence of cash does not prevent deductibility for the following reasons:

1. *We are, under this Point I, claiming a bad debt deduction on the notes of the corporation acquired as aforesaid—not a business loss represented by the new personal notes given.*

This is the vital distinction to be kept in mind.

We do not claim a business loss represented by the new personal notes—we claim a deduction for the corporation's notes, ascertained to be worthless in 1925.

2. *In such a case, the presence of cash is not required by the authorities or by a reasonable construction of the Statute.*

We believe that the lower Courts have confused this case with the cases where a taxpayer on a cash basis attempts to claim a loss for notes given by him but not yet paid.

Without discussing the merits of such cases, in any event they have no application here, where the deduction is based on the notes acquired.

Under the authorities, the taxpayer is entitled to deduct his share of the worthless notes in 1925.

To the best of our knowledge there are only three cases in which this question has been squarely considered—and all of them are decisive of the question in our favor.

S. R. Davis v. Commissioner, 9 B. T. A., 755, Reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928. (Vol. I 1931 C. C. H. Tax Service, Par. 207, 342).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidating dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

The second case in which the point here involved is considered is:

A. W. D. Weis v. Commissioner, 13 B. T. A., 1284.

In the case cited, the petitioner and one Morgan conducted a lumber company which gave to the bank its notes. In 1919 the bank called the notes and the petitioner gave

his personal note for the amount of the principal and interest due on the company's note which he took up. The business was wound up in 1919 and it was then ascertained that the company would have little or no assets to apply on its note. The personal note given by the petitioner was not paid until 1923. Nevertheless the petitioner was allowed to deduct in the year 1919 the amount of the principal and interest due on the corporate notes which he had taken up.

The third case in which the point here at issue has been considered is that of

> *Maurice Sass v. Commissioner*, 7 B. T. A., 557; Modified in 12 B. T. A., 156; Affd. in 17 B. T. A., 261.

Here the petitioner claimed as a deduction the amount due on notes guaranteed by the petitioner which he had been obliged to take up and for which he had substituted his own notes not paid in the taxable year. The final holding of the Board was that the deduction could not be taken because it was not shown that the notes taken up were worthless in the year in which taken up. The Board said in part in 17 B. T. A., at 263:

> "* * * petitioner has not shown that he is entitled to a deduction of $19,253.54 by reason of the fact that he gave his note in that amount to the bank in the year 1919. Even under the petitioner's claim, in order to become entitled to a deduction of this amount, it is incumbent upon him to show by a preponderance of the evidence that the obligations of the borrowers, whose notes he had guaranteed, were worthless in the year 1919 and this he has failed to do. The mere fact that the bank called upon peti-

tioner to take care of the unpaid notes of others, the payment of which he had guaranteed, and that he gave to the bank his promissory note, does not of itself prove that he has sustained a deductible loss in the year in which he gave his note. When petitioner gave his note to the bank he was subrogated to all rights of the bank against the makers of the notes remaining unpaid at that time and there is not sufficient evidence in this record to convince the Board that the notes given to the bank and taken over by petitioner were worthless and uncollectible in the taxable year. This fact distinguished this case from the proceeding of *S. R. Davis*, 9 B. T. A., 755, and *A. W. D. Weis*, 13 B. T. A., 1284."

But in the case at bar there is proof — and in fact no contention to the contrary—that the notes of the corporation which the petitioner took up were worthless and were ascertained to be worthless in the year 1925; the Board finding that "subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600.00"; and the petitioner and Ainsworth being obliged to take care of the rest by giving their note for the deficiency of $44,800.00.

Certainly if a taxpayer purchases stock, giving his note in payment, and later sells the stock at a loss, he may deduct the loss, though the note be not paid at that time. So it is held that where merchandise is bought and sold during the taxable year, though not fully paid for until a subsequent year, it is nevertheless to be included in purchases for the taxable year in computing income of one who is on a cash basis.

Appeal of Bob H. McGinnis, 4 B. T. A., 209.

So here, when the taxpayer acquires the corporation's notes, and these are ascertained to be worthless and charged off, the right to a deduction therefor would seem to be clear.

There is nothing in the Statute that requires the payment of cash, or that indicates any such requirement; but were there any ambiguity it is to be resolved in favor of the taxpayer, under the rule of law already stated.

3. *To insist on the presence of cash is to insist on a meaningless form.*

The situation, effect and result of the transaction is exactly the same as if the petitioner and Ainsworth in 1925 had gone to the bank, given their notes, deposited the proceeds in their accounts, checked it out to the bank and taken up the notes of the corporation.

The mode adopted was merely a short cut of this transaction; the same purpose was served and the same result achieved.

It would seem unnecessary to insist on a mere matter of useless form; the result would seem to be the proper test.

We shall not, however, pursue this angle further, since if the Commissioner's sole requirement is the presence of tangible consideration passing from the taxpayer, this requirement can readily be met.

4. *As to* $25,000.00 *of the notes, the petitioner has actually paid out tangible consideration.*

The taxpayer and Ainsworth in 1922 had partnership property and partnership liabilities, among them notes in the amount of $25,000.00.

They parted with the property in 1922 in return for the assumption of the liabilities.

In other words, the partners conveyed their property in return for the corporation's promise to pay the liabilities, and hold the partners indemnified.

This obligation of the corporation was represented at least up to $25,000.00, by the notes on which the corporation was primarily liable as maker and the individuals secondarily liable as indorsers; and with respect to which the corporation was bound to hold the indorsers harmless not merely by the express agreement of 1922, but also by the implied obligation imposed by law.

This obligation, represented by these notes, became worthless in 1925.

The petitioner had transferred his property in 1922 for this obligation. He had paid for it in tangible consideration in 1922. If it becomes worthless in 1925, why cannot he deduct it?

The suggestion was made that when the individuals in 1925 gave their notes, they were remitted to their 1922 position. That is not so—their liabilities have returned, but their properties have not.

"(e) The Commissioner under Section 212 of the Revenue Act of 1926 has no power to deprive the petitioner of his specific right to a deduction from income conferred by Section 214(a) of that Statute.

Upon the arguments in the Courts below there was mentioned the authority of the Commissioner in respect to the computation of income of a taxpayer under

Revenue Act of 1926, Section 212.

"Sec. 212(a) In the case of an individual the term "net income" means the gross income as defined in Section 213, less the deductions allowed by Sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income."

It would seem that the above entitled section confers no right on the Commissioner to make the adjustment attempted in the case at bar.

In the first place, as will be pointed out hereafter, the method employed by the taxpayer most clearly reflects his income and his financial situation.

In the second place, a general statutory provision such as Section 212(b) has never been held to confer authority on the Commissioner to deprive a taxpayer of a deduction, the right to which is specifically given under Section 214 of the same act.

It is universally held that general language does not limit a specific right conferred by clear and specific language. The rule is so well known as to require no citation; but it is aptly phrased in:

Kepner v. United States, 195 U. S. 100 at 125.

"It is a well settled principle of construction that specific terms covering the given subject matter will prevail over general language of the same or another statute which might otherwise prove controlling."

(d) The treatment of the transaction urged by the petitioner most accurately reflects the true situation.

It was in the year 1925 that it was definitely ascertained that the taxpayer would be obliged to take up the notes of the corporation. It was in the same year that these notes were taken up and acquired; and it was in the same year that these notes were written off as worthless. It was in the year 1925 that it was definitely ascertained that the taxpayer had sustained this loss; it was in that year that his net worth was correspondingly reduced; and it most accurately reflects the true situation to show this transaction in the year in which it occurred.

To postpone the deduction until cash is paid might mean the distortion of income, and by a juggling of checks and notes a taxpayer might shift the loss to any year he should see fit to select. The method urged by the petitioner on the contrary most clearly reflects the true status of the affairs. This is pointed out in the decision already referred to.

A. W. D. Weis v. Commissioner of Internal Revenue, 13 B. T. A., 1284 at 1289.

"We are of the opinion that all the losses here in question were sustained in the years in which the several investments became worthless. In such respective years each of the deals became a closed transaction and the petitioner's net assets were reduced in the amount of the loss sustained. It is not material

whether such losses were met by the payment of cash from funds in hand or with cash borrowed from the bank and evidenced by notes payable in a subsequent year. The loss had been sustained and the transaction had been closed by a cash payment. The use of the petitioner's credit to secure funds from the bank was a new and different deal and had no more to do with the petitioner's tax liability than any other borrowing that he did in the taxable year. *Cf. Bob H. McGinnis*, 4 B. T. A., 209.

If the deductions herein claimed are allowed for the respective taxable years in which the losses occurred, correct income and true tax liability for such years may be determined. If postponed, manifestly income of the years to which they are eventually applied and to which they have no proper application will be distorted."

POINT III

Were an additional ground necessary to permit deduction it might be found on the theory of a business loss sustained by petitioner and deductible under Section 214(a)(4)(5) of the Revenue Act of 1926.

As already stated, the petitioner's primary contention is that he should be allowed a bad debt deduction on his one-half of the notes of the corporation which he was obliged to take up as aforesaid and which were ascertained to be worthless and charged off in 1925.

There is however another alternative—the treatment of the transaction as one giving rise to a business loss measured by the new personal notes given.

Revenue Act of 1926, Sections 214(a)(4)(5).

"Sec. 214(a) In computing net income there shall be allowed as deductions:

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

We believe that the only objection to a deduction under the foregoing statutory provisions is the absence of cash appearing in the transaction.

We can see nothing in the Statute that requires the presence of cash. The transaction was closed in the year 1925; the various matters were completed; and it was definitely ascertained at that time that the petitioner would sustain the losses in question.

It is true that no cash was paid at that time; but it is also true that there is nothing in the Statute to indicate that this requirement is necessary.

We shall not however pursue this argument further since we believe the petitioner's right to the deduction is established under Points I and II, supra, relating to the deduction as a bad debt of the notes taken up by the petitioner.

CONCLUSION

For the foregoing reasons the judgment of the Circuit Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted,

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SEP 10

No. 351

In the Supreme Court of the United States

OCTOBER TERM, 1930

A. JAMES ECKERT, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose the petition in this case.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 12–17) is reported in 17 B. T. A. 263. The opinion of the Circuit Court of Appeals (R. 27–30) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 9, 1930. (R. 30.) A petition for rehearing was denied July 7, 1930. (R. 35.) The

petition for a writ of certiorari was filed August 14, 1930. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1925 petitioner and another were required by a bank to substitute their own notes for notes of a corporation which they had endorsed. At this time the corporation had no assets, had discontinued business, and was in process of dissolution. Petitioner did not in 1925 pay any cash to the bank on the notes which he made in that year.

In computing his net income for that year was petitioner entitled to deduct any portion of the notes as a "debt ascertained to be worthless and charged off within the taxable year" under Section 214 (a) (7) of the Revenue Act of 1926?

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, 27, 69:

> SEC. 214. (a) In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part;
>
> * * * * *
>
> (U. S. C. App., Title 26, Sec. 955.)

EFFECTIVE DATE OF TITLE

SEC. 286. This title shall take effect as of January 1, 1925, except that section 257 and sections 271 to 285, inclusive, and this section, shall take effect on the enactment of this Act.

STATEMENT

The facts are not in dispute (R. 12–14):

Prior to 1922 the petitioner and William A. Ainsworth were engaged in business as partners. In 1922 they organized a corporation which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, New York, for money loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several additional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were indorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently, in 1925, the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600. This amount was paid on the notes by the corporation in December, 1925, leaving an unpaid

balance of $44,800. Concurrently with the payment of $600 by the corporation, the petitioner and Ainsworth delivered to the bank their joint note for $44,800 in settlement of their liability as indorsers of the corporation's notes and in return received the corporation's notes stamped "paid." These notes were subsequently destroyed by the petitioner.

The liquidation of his liability as an indorser of the corporation's notes did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of account. His return for the taxable year was filed on the basis of cash received and disbursed.

The Commissioner of Internal Revenue declined to allow any amount of the notes as a deduction from gross income on the ground that no cash payments were made on the notes during the taxable year and determined a deficiency for the year 1925 in the sum of $3,378.89.

The Board of Tax Appeals held that the petitioner was not entitled to a deduction of the amount claimed, either as a loss or as a worthless debt of the corporation and approved the Commissioner's determination. (R. 17.) The Circuit Court of Appeals for the Second Circuit affirmed the Board's determination. (R. 30.)

DISCUSSION

The ultimate basis upon which the Circuit Court of Appeals sustained the determination of the

Commissioner appears in the following extract from the opinion (R. 29–30):

> The taxpayer not having sustained a loss because he did not pay the note or any part thereof in the year 1925, the Commissioner properly held that he was not entitled to this deduction. Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it.

The decision in this case seems to be in conflict with that of the Circuit Court of Appeals for the Seventh Circuit in *S. R. Davis* v. *Commissioner*, rendered October 24, 1928, and not reported. That Circuit Court of Appeals reversed without opinion the decision of the Board of Tax Appeals. (9 B. T. A. 755.) The findings of fact in the *Davis case* (9 B. T. A. 755, 756) disclose that the notes were not worthless when received, and that previous to the deduction they had been taken into the taxpayer's investment accounts as an asset. But as it seems doubtful whether it was because of these facts that the Circuit Court of Appeals for the Seventh Circuit decided the case in favor of the taxpayer, the two cases appear to be in conflict.

CONCLUSION

In view of the conflict of the decision in the instant case with the decision of the Circuit Court of

Appeals for the Seventh Circuit in *Davis* v. *Commissioner*, we do not oppose the issuance of the writ.

Respectfully submitted.

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SEPTEMBER, 1930.

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No. 351

In the Supreme Court of the United States

OCTOBER TERM, 1930

A. JAMES ECKERT, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 8–10) is reported in 17 B. T. A. 263. The opinion of the Circuit Court of Appeals (R. 15–17) is reported in 42 F. (2d) 158.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 9, 1930. (R. 18.) A petition for rehearing was denied July 7, 1930. (R. 18.) Petition for certiorari was filed August 14, 1930, and certiorari was granted on October 20, 1930.

(R. 19.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1925 petitioner and another individual were required by a bank to substitute their own joint note for notes of a corporation which they had endorsed. At this time the corporation had no assets, had discontinued business, and was in process of dissolution. Petitioner did not, in 1925, pay any cash to the bank on the note which he made in that year. Petitioner's return was filed upon the cash basis.

In computing his net income for that year, was petitioner entitled to deduct any portion of the notes as a "loss sustained during the taxable year" or a "debt ascertained to be worthless and charged off within the taxable year," under Section 214 (a) (4) or (7) of the Revenue Act of 1926?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9, 10, 23, 26, 69.

TITLE II

SEC. 200. When used in this title—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions

and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. (U. S. C. App., Title 26, Sec. 931.)

SEC. 212. (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (U. S. C. App., Title 26, Sec. 953.)

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

* * * * * *

(7) Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part; * * *. (U. S. C., App., Title 26, Sec. 955.)

SEC. 286. This title shall take effect as of January 1, 1925, except that section 257 and sections 271 to 285, inclusive, and this section, shall take effect on the enactment of this Act.

Treasury Regulations 69:

ART. 23. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 200 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. (See sections 200 (d) and 213 (a).) For instance, in any case in which it is necessary to use an inventory, no

accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See articles 51 and 52.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see article 1615.) * * *.

STATEMENT

The record does not contain the evidence. The Board of Tax Appeals made the following findings of fact (R. 7–8):

Prior to 1922 the petitioner and William A. Ainsworth were engaged in business as partners under the firm name of Electric Refrigeration Company. In 1922 they organized a corporation under the name of Electric Refrigeration Co., Inc., which acquired all of the assets and assumed all of the liabilities of the partnership, including certain notes, totaling $25,419.65, payable to and held by the Citizens Trust Company of Utica, N. Y., for money loaned to the partnership. The bank subsequently accepted notes executed by the corporation for the partnership notes. Between 1922 and 1925 the corporation issued several additional notes in the amount of $19,375.25, in favor of the same bank for loans. All of the notes issued by the corporation in favor of the bank were endorsed by the petitioner and Ainsworth.

In September, 1925, the bank made a demand upon the corporation for payment of the latter's notes. Subsequently, in 1925, the corporation discontinued business and proceeded to wind up its affairs. Its assets on dissolution were sufficient to pay only $600 on the notes. This amount was paid by the corporation in December, 1925, leaving an unpaid balance of $44,800, after charging about $5 to the personal account of the petitioner. Concurrently with this payment of $600 by the corporation the petitioner and Ainsworth delivered to the bank their joint note for $44,800 in settlement of their liabilities as endorsers of the corporation's notes, and in return received the corporation's notes stamped "paid." The notes were subsequently destroyed by the petitioner.

The liquidation of petitioner's liability as an endorser of the corporation's note did not involve the payment of any cash. The petitioner has never collected anything on the notes he and Ainsworth paid. He did not keep books of account. His return for the taxable year 1925 was filed on the cash basis.

The petitioner in his return for 1925 claimed a deduction of $22,400 on account of this transaction. The Commissioner declined to allow him any deduction on account of the transaction, basing his decision on the fact that no cash payment was made by petitioner during the taxable year.

The Board held that the petitioner was not entitled to a deduction of the amount claimed, either

as a loss or as a worthless debt of the corporation, and approved the Commissioner's determination. On appeal, this decision was affirmed by the Circuit Court of Appeals for the Second Circuit.

SUMMARY OF ARGUMENT

We concede that under the facts in this case the petitioner will be entitled to a deduction in the year in which he makes any payment on the note, but as his return was rendered on the cash basis he can not take a loss until he pays cash.

ARGUMENT

The petitioner seeks to deduct the amount of the note which he gave in 1925 under the provisions of Section 214 (a) (4) or (7) of the Revenue Act of 1926, p. 4, *supra*.

The Government does not contend that the taxpayer may not at some time be entitled to a deduction either on account of a bad debt or for a business loss.[1] The sole question in dispute is

[1] The Bureau of Internal Revenue has consistently ruled that an accommodation endorser or guarantor of a note may deduct the amount which he has to pay on account of his liability as endorser when the principal debtor becomes insolvent. Office Decision 556, published in 2 Cumulative Bulletin (January-June, 1920), p. 137; Solicitor's Memorandum 1298, published in 2 Cumulative Bulletin (January-June, 1920), p. 113; A. R. R. 479, published in 5 Cumulative Bulletin (July-December, 1921), p. 146; Income Tax Decision 2012, published in III–1 Cumulative Bulletin (January-June, 1924), p. 158; Income Tax Decision 2025, published in III–1 Cumulative Bulletin (January-June, 1924), p. 166. See also *Heyn* v. *Commissioner*, 4 B. T. A. 1256.

whether the taxpayer is entitled to the deduction in 1925, the year in which his note was given, or in the later year in which the taxpayer's liability on the note is actually liquidated by payment.

The petitioner reported his income on the cash basis. This basis requires that he report only actual receipts and deduct only actual disbursements, as distinguished from the accrual basis, which permits pecuniary obligations payable to or by the taxpayer to be treated as if discharged when incurred. All items are required to be treated with reasonable consistency. Article 23, Regulations 62, *supra*.

The worthless notes in the transaction here involved must be treated in such a manner as will be consistent with the cash receipts and disbursements method of accounting. If an inconsistency is established, it is competent for the Commissioner to correct the return to conform it to the system of accounting in fact adopted. *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92. In *United States* v. *Mitchell*, 271 U. S. 9, 12–13, where a similar provision of the 1918 Act was involved, this Court said:

> * * * it is the purpose of the Act to require returns that clearly reflect taxable income. That purpose will not be accomplished unless income received and deductible disbursements made are treated consistently. It was not the purpose of the Act to

> permit gross income actually received to be diminished by taxes or other deductible items disbursed in a later year, even if accrued in the taxable year. It is a reasonable construction of the law that the same method be applied to both sides of the account.

That case held that where an income-tax return for an estate is made on the basis of income actually received in the taxable year there may not be deducted the estate tax accruing in that year but paid in the following year.

When petitioner and his coëndorser gave their personal note in exchange for the notes of the corporation, they merely discharged one liability by the assumption of another, and the petitioner paid no cash. As he was on the cash basis, a deduction, whether for a loss under Section 214 (a) (4) or for a bad debt under Section 214 (a) (7), is permissible only for that taxable year in which he pays cash.

The situation here is unlike that in which a taxpayer pays off an obligation with the note of a third party. In such a case the note has value in the hands of the taxpayer; it may be an asset which in his hands is the equivalent of cash. As the Circuit Court of Appeals said (R. 17):

> The giving of a note does not constitute a cash payment. The obligation to pay the amount of the note may be as binding, for instance, as payment of taxes, but it has been determined that a taxpayer on a cash received and disbursed basis can not deduct taxes before they are actually paid. *United*

> *States* v. *Mitchell, supra.* Nor can a taxpayer, who subscribes to a charitable fund, deduct the subscription until he has paid it. *Mann* v. *Commissioner* (App. D. C. 1929), 35 F. (2d) 873. The taxpayer not having sustained a loss because he did not pay the note or any part thereof in the year 1925, the Commissioner properly held that he was not entitled to this deduction. * * *

See also *Blair* v. *First Trust & Savings Bank,* 39 F. (2d) 462 (C. C. A. 5th), certiorari denied, 282 U. S. xi, where it was held that where a bank made its return on the cash basis notes which it received as commissions for making loans were not income until the notes were paid.

That the petitioner is entitled to no deduction for the year 1925 is further shown by the fact that the note was a joint note signed by him and by his partner, Ainsworth. The petitioner seeks to deduct half of the face amount of this note as his share of the joint loss. But it is not certain that the petitioner will eventually pay half of the amount of the note. His liability as a joint maker of the note is for its entire face value. The petitioner may eventually have to pay the entire amount of the note, or it may develop that the partner, Ainsworth, will have to pay the entire amount of the note because of petitioner's insolvency or failure to pay his share. It does not appear in the findings that the petitioner's share of the liability on the joint note was one-half the

total. It may have been that as between the petitioner and Ainsworth, Ainsworth was primarily liable for the whole amount or some part of it, more or less than one-half. Under these circumstances we submit that it is plain that the petitioner, who made his return on the cash basis, may not properly deduct the liability evidenced by the note until that liability has been discharged by payment.

It is unimportant that a different result might have been reached if petitioner had pursued a different course. Even if it is true that the deduction might be allowed if the taxpayer had borrowed money on his own note and had then drawn a check to satisfy the note of the corporation, that is not this case. Tax liability often varies according to the form which the transaction actually takes. In *Weiss* v. *Stearn,* 265 U. S. 242, 254, this Court said:

> Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants; and when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form.

See also *Miles* v. *Safe Deposit Co.,* 259 U. S. 247; *United States* v. *Phellis,* 257 U. S. 156, 172; *Remington Rand, Inc.,* v. *Commissioner,* 33 F. (2d) 77, 78, certiorari denied, 280 U. S. 591.

Nor does it militate against the force of our contention that a loss may become complete enough

for deduction without the taxpayer's establishing that there is no possibility of an eventual recoupment. In *United States* v. *White Dental Co.*, 274 U. S. 398, a loss had been actually sustained through the seizure of property by the German sequestration, which left the corporation without right to demand its release or obtain immediate compensation. Here the situation is different, as the loss has been in fact postponed by the giving of a note and will not be complete until the note is paid.

In *S. R. Davis* v. *Commissioner*, 9 B. T. A. 755, the Board of Tax Appeals reached a conclusion similar to its decision in this case. However, that case was reversed by the Circuit Court of Appeals for the Seventh Circuit, without opinion, on October 24, 1928. Inasmuch as the court gave no reason for its decision, it is of little value as a precedent. Possibly the decision of that Circuit Court of Appeals may be accounted for by the fact that the notes in that case were not, like those here, worthless when received and that previous to the deduction they were taken into the taxpayer's investment accounts as an asset.

Another reason why the taxpayer is not entitled to deduction as a bad debt is because he did not "charge off" the debt within the taxable year. The debt did not arise until the taxpayer gave his note to the bank. Cf. *Lewellyn* v. *Electric Reduction Co.*, 275 U. S. 243. At that time the debt was

worthless and the taxpayer had no asset which he could "charge off." The Circuit Court of Appeals said (R. 17):

> Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it.

CONCLUSION

The decision of the Circuit Court of Appeals for the Second Circuit should be affirmed.

Respectfully submitted.

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MARCH, 1931.

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v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE RESPONDENT

In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 351

A. JAMES ECKERT, PETITIONER

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE RESPONDENT

In addition to the rulings of the Bureau of Internal Revenue mentioned in the footnote on page 7 of our original brief, we direct the attention of the Court to the following rulings and decisions which are not cited in our original brief:

I. T. 1167, PUBLISHED IN 1-1 CUMULATIVE BULLETIN (JANUARY–JUNE, 1922), P. 149

During 1916 A was induced to invest $10,000 in the stock of a proposed corporation. A gave his note for the amount and the stock was issued.

During 1916 it developed that the stock was worthless. A's note had been discounted at a bank. During 1917 A paid x dollars on the note discounted at the bank and gave a new note for $4x$ dollars, which amount he paid in 1918. The ruling was that, assuming A to be on the cash basis, he could not deduct any loss until he paid something on the note. The memorandum concluded with this statement:

> A may deduct the payments on the note in computing the income for the years in which such payments were made. The fact that the loss was discovered in 1916 is immaterial, because the date of discovery does not determine the date on which the loss was sustained.

A. R. M. 201, PUBLISHED IN II-1 CUMULATIVE BULLETIN (JANUARY-JUNE, 1923), P. 86

Here the Committee concurred in the views expressed in an informal opinion of the Solicitor of Internal Revenue of September, 1922. This involved the case of a taxpayer who had endorsed certain notes, and on account of the bankruptcy of the maker of the notes he was called upon to pay them. He did this by making part payment in cash in 1920 and giving four notes payable in later years. The Solicitor and the Committee on Appeals and Review held that if his returns were upon the accrual basis the deduction of the entire amount

of the notes should be taken in the 1920 return, but that if the return was made upon the cash basis deduction could be taken in the 1920 return only for the amount paid in that year and the remaining amounts should be taken as deductions in the years in which those amounts are actually paid.

In *Miniger* v. *Denman*, decided July 2, 1930, by the District Court for the Northern District of Ohio (reported in paragraph 1325 of the Prentice-Hall Federal Tax Service for 1930), the following paragraph appears in the journal entry:

> 2. That the plaintiff made his income-tax return for the year 1921 upon the cash receipts and disbursements basis; that a part of the agreed purchase price to be paid by the plaintiff for the Common Stock of Willys Corporation owned by him during said year is represented by a demand note in the amount of $60,000 to the order of John N. Willys, from whom plaintiff purchased said stock; that said note has not been paid and is still outstanding in the hands of John N. Willys, the original payee; that to the extent that the purchase price of said stock is represented by said note, the loss thereon is properly deductible, not at the time the stock became worthless, but at the time of payment of said note if, when, and to the extent that said note shall be paid, to which plaintiff excepts.

See, also, *Osterloh* v. *Lucas*, 37 F. (2d) 277 (C. C. A. 9th).

Respectfully submitted.

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MARCH, 1931.

U. S. GOVERNMENT PRINTING OFFICE: 1931

SUPREME COURT OF THE UNITED STATES.

No. 351.—October Term, 1930.

A. James Eckert, Petitioner, *vs.* David Burnet, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 13, 1931.]

Mr. Justice Holmes delivered the opinion of the Court.

The Commissioner of Internal Revenue determined that there was a deficit of $3,378.89 in the petitioner's income tax for the year 1925 under the Revenue Act of 1924. The petitioner claimed a deduction from income of $22400 as a bad debt. The deduction was disallowed by the Commissioner, by the Board of Tax Appeals and, in review, by the Circuit Court of Appeals for the Second Circuit. 42 F. (2d) 158. A writ of certiorari was allowed by this Court.

The petitioner's tax return was on the cash basis. The facts of the transaction concerned were that the petitioner and his partner were joint endorsers of notes issued by a corporation that they had formed. There remained due upon these notes $44800, that the corporation was unable to pay. In 1925 the petitioner and his partner in settlement of their liability made a joint note for that sum to the bank that held the corporation's paper, received the old notes, marked paid, and destroyed them. The petitioner claims the right to deduct half that sum as a debt "ascertained to be worthless and charged off within the taxable year" under the Revenue Act of 1926, c. 27, § 214 (a) (7); 44 Stat. 9, 27.

It seems to us that the Circuit Court of Appeals sufficiently answered this contention by remarking that the debt was worthless when acquired. There was nothing to charge off. The petitioner treats the case as one of an investment that later turns out to be bad. But in fact it was the satisfaction of an existing obligation of the petitioners, having, it may be, the consequence of a moment-

ary transfer of the old notes to the petitioner in order that they might be destroyed. It is very plain we think that the words of the statute cannot be taken to include a case of that kind. We do not perceive that the case is bettered by the fact that some of the original notes years before were given for property turned over to the corporation by the partnership that formed it. For the purpose of a return upon a cash basis there was no loss in 1925. As happily stated by the Board of Tax Appeals the petitioner "merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value." A deduction may be permissible in the taxable year in which the petitioner pays cash. The petitioner says that it was definitely ascertained in 1925 that the petitioner would sustain the losses in question. So it was, if the petitioner ultimately pays his note. So was the tax considered in *United States* v. *Mitchell*, 271 U. S. 9, 12, but it could not be deducted until it was paid.

Judgment affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.